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September 11, 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: Amendment of Parts 65 and 69 of
the Commission's Rules to Reform
the Interstate Rate of Return
Prescription and Enforcement
Processes

CC Docket No. 92-133

Dear Ms. Searcy:

Enclosed herewith for filing with the Commission are the original
and nine copies of the National Exchange Carrier Association,
Inc.'s Comments in the above-captioned matter.

Please acknowledge receipt hereof by affixing a notation on the
duplicate copy of this letter furnished herewith for such
purposes and remitting same to bearer.

Very truly yours,

Joanne S. Bochie
Joanne S. Bochie

JSB/bas
Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20584

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of:

Amendment of Parts 65 and 69 of
the Commission's Rules to Reform
the Interstate Rate of Return
Processes

CC Docket No. 92-133

COMMENTS OF THE
NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.

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September 11, 1992

SUMMARY

The National Exchange Carrier Association, Inc. (NECA) is submitting these comments in response to the Commission's Notice of Proposed Rulemaking in CC Docket No. 92-133, Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes. While NECA supports the Commission's review of the rate of return process and its goal to reduce unnecessary regulatory burdens, NECA asserts that simplification should not undermine the primary goal of accuracy in determination of the critically important unitary rate of return. NECA agrees with the Commission that it is in the public interest to retain the current 11.25 percent rate of return prescription.

In addition, NECA emphasizes the historical significance and importance of retaining a unitary rate of return for interstate access services based upon Bell Operating Company data. NECA states that it is willing to provide assistance to the Commission in its rate of return data-gathering effort and explains that the data must be from Bell Operating Company or other publicly available data sources. Data from small companies necessary for rate of return calculations is not currently collected and would pose an additional administrative burden which the Commission has stated it wishes to avoid.

NECA completes its comments with several recommendations for modifications to the Commission's rate of return represcription enforcement procedures. These recommendations include NECA's

support for the continued use and sufficiency of the tariff review and complaint processes as the primary enforcement tools. NECA does not believe that an automatic refund rule can be justified or is required. An additional NECA recommendation is that the Commission should prescribe the authorized rate of return on a total interstate access basis for the NECA pools.

Because of small company earnings volatility, NECA further recommends that the Commission adopt a 100 basis point buffer zone for total interstate access earnings enforcement and supports at least a two-year rate of return monitoring period for the NECA pools.

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the Interstate Rate of Return
Represcription and Enforcement
Processes

CC Docket No. 92-133

COMMENTS

The National Exchange Carrier Association, Inc. (NECA) submits these comments in response to the Commission's Notice of Proposed Rulemaking in the above captioned proceeding.¹ NECA is a not-for-profit corporation serving every local exchange carrier study area in the United States, Puerto Rico and the U.S Virgin Islands. Each of these over 1400 member study areas is subject to the rate of return procedures under review in this proceeding.

I. NECA SUPPORTS THE COMMISSION'S OBJECTIVES IN THIS RULEMAKING.

NECA supports the Commission's review of the rate of return represcription process and the goal to reduce unnecessary regulatory burdens on exchange carriers (ECs). Simplification should not, however, proceed at the expense of reasonable accuracy in determining the critically important unitary rate of return.

¹ Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes, Notice of Proposed Rulemaking and Order, CC Docket No. 92-133, 7 FCC Rod 4688 (1992) (Notice).

NECA also supports the Commission's belief that the current rate of return prescription will continue to result in rates within a zone of reasonableness.² NECA supports the Commission's determination that it is in the public interest to defer initiating another interstate rate of return prescription pending further action in this proceeding.

In these comments, NECA:

- continues to support the use of the unitary rate of return for interstate access services which is based upon Bell Operating Company data;
- states its willingness to assist the Commission in its rate of return data-gathering effort;
- outlines its view that ratepayers are fully protected by the tariff review and complaint processes; and
- recommends that the unitary rate of return should be prescribed on a total interstate access level only, with maximum earnings allowable to 100 basis points over authorized levels for a two-year monitoring period.

II. NECA CONTINUES TO SUPPORT THE UNITARY RATE OF RETURN FOR INTERSTATE ACCESS SERVICES BASED UPON BELL OPERATING COMPANY DATA.

Use of the unitary rate of return is and has been a longstanding Commission practice supported by EC industry agreements and Commission orders. The 1984 and 1986 Unity Agreements were central to achieving the orderly evolution of the Commission's Access Charge Plan.³ The Unity Agreements are

² Notice at ¶ 103.

³ See Joint Petition of the National Telephone Cooperative Association, the Organisation for the Protection and Advancement of Small Telephone Companies, the National Rural Telecom Association, and the United States Telephone Association, filed October 26, 1984

integrated programs carefully crafted by all members of the EC industry to balance universal service goals with the development of a competitive telecommunications market.⁴ The 1986 Unity 1-A Agreement was included in the Joint Board's Recommended Decision and Order and subsequently adopted by the Commission virtually as submitted.⁵ Within the Unity 1-A Agreement, the unitary rate of return is described as:

"an average industry return on capital for rate development, high cost formula calculations, and to the extent earned, for pool settlements."⁶

Additionally, the Commission has explained its preference for

in CC Docket Nos. 78-72 and 80-286 (The Unity Agreement) and The 1986 Unity 1-A Agreement filed by these parties on July 25, 1986 in CC Docket Nos. 78-72 and 80-286 (The Unity 1-A Agreement).

⁴ The Unity 1-A Agreement contains significant EC-initiated proposals such as: 'refocusing the objectives of the Universal Service Fund; suggesting the establishment of Lifeline Assistance Programs with the administration of these programs on a state-by-state basis; replacing the mandatory NECA Common Line Pool with a voluntary NECA Common Line Pool; establishing Long Term and Transitional Support mechanisms to minimize the impact of a voluntary Common Line Pool by assuring that the NECA carrier common line charge will not exceed the approximate charge that would have been in effect if a mandatory pool were still in existence and; endorsing an overall, industry rate of return for use by all carriers for rate development, high cost formula calculations and pool settlements. NECA was assigned and continues to play an integral role in implementing each of these EC and Commission goals.

⁵ See MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Recommended Decision and Order, CC Docket Nos. 78-82 & 80-286, 2 FCC Rod 2324 (1987) and MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Order, CC Docket Nos. 78-72 & 80-286, 3 FCC Rod 4543 (1988).

⁶ The Unity 1-A Agreement at p. 7.

the use of the unitary rate of return as follows:

"Despite the criticisms raised by some of the parties, we continue to believe that a single LEC grouping should be utilized. A unitary approach best balances administrative ease with fairness and accuracy. . . More important than administrative savings, however, is our belief that a single grouping should be used because of the nature of interstate exchange access service, with carriers facing very similar risks in providing this service."⁷

Since the Bell Operating Companies (BOC) represent 70 to 80 percent of the total EC industry revenue requirement⁸ and since the risks associated with providing interstate access service are similar for all ECs, BOC data should continue to serve as the basis for calculating the cost of capital for the industry as a whole. BOC data, unlike data from smaller companies, is readily available, is generally statistically more robust and is better suited for empirical use. Further, the collection and use of smaller company data for rate of return representations is diametrically opposed to the central objective of this proceeding -- to reduce unnecessary regulatory burdens on all parties.

All ECs and NECA have supported, and continue to support, the use of a unitary rate of return. Wherever there is a need for an interstate access rate of return, it should be the same for all

⁷ See Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, Order, CC Docket No. 84-800, Phase II, 104 F.C.C. 2d 104 (1986) at § 7; and Errata, 51 Fed. Reg. 4596, February 6, 1986 and 51 Fed. Reg. 15328, April 23, 1986.

⁸ See Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, Notice of Proposed Rulemaking, CC Docket No. 92-135, (FCC 92-258), released July 17, 1992 (Small/Midsize Notice); and Erratum released July 29, 1992.

ECs. Exchange carriers subject to price cap regulation are linked with the unitary rate of return by their Universal Service Fund (USF) calculations.⁹

III. NECA IS WILLING TO ASSIST THE COMMISSION WITH ITS RATE OF RETURN DATA-GATHERING EFFORT.

The Notice states that "it may also be that most or all [represcription] information could be collected and submitted by a LEC organization, such as the National Exchange Carrier Association, Inc."¹⁰ NECA is willing to serve in this manner to aid the Commission with changes to its rate of return represcriptions.

NECA agrees with the Commission that the proposed responsibilities could be structured in a way that minimally affects NECA's operating expenses. However, until NECA's role is clearly defined it will not be possible to ascertain the actual financial impact. NECA also agrees that, as proposed, the cost of any additional responsibilities should be classified as Category I expenses.

To assist the Commission with its represcription responsibilities, however, NECA must rely exclusively upon publicly available BOC data and purchases of available data from outside the

⁹ Section 36.621 of the Commission's Rules (47 C.F.R. §36.621) prescribes the use of the unitary rate of return for calculating every study area's unseparated loop cost. That result is then used in determining both the nationwide average unseparated loop cost and each study area's eligibility for universal service fund amounts.

¹⁰ Notice at ¶ 41.

EC industry. NECA does not presently collect data from its members that could be used in a represcription process. Any additional data collections, from pool participants and non-pool participants alike, would add to ECs' administrative burdens.

IV. NECA RECOMMENDS MODIFICATIONS TO THE COMMISSION'S RATE OF RETURN REPRESRIPTION ENFORCEMENT PROCEDURES.

The Commission seeks comment on a number of issues regarding compliance with its interstate access rate of return represcriptions including: a) whether to repeal its automatic refund rule and rely instead upon tariff review and complaint processes;¹¹ b) whether earnings monitoring should be on an overall interstate access basis;¹² c) whether the current buffer zones are adequate for the remaining rate of return ECs;¹³ and d) whether the current two-year monitoring period should be changed.¹⁴ NECA's comments address each of these issues as they apply to the NECA pools under traditional rate of return regulation.

IV.A. Ratepayers are Fully Protected by the Tariff Review and Complaint Processes.

NECA agrees with the Commission's tentative conclusion that tariff review and complaint processes, not an automatic refund

¹¹ Notice at ¶ 98.

¹² Notice at ¶ 100.

¹³ Notice at ¶ 101.

¹⁴ Notice at ¶ 102.

rule, should be relied upon as the primary earnings enforcement mechanisms for traditional rate of return carriers. Occurrences of overearnings have been identified and addressed for many years without an automatic refund provision.¹⁵

NECA has previously commented that a mechanized or "automatic" refund rule treats all overearnings situations alike and precludes consideration of other factors involving issues of equity and the public interest.¹⁶ An in-depth review of an EC's earnings performance is necessary to ensure fair treatment of all parties involved. The courts have recognized that an agency which orders refunds must consider all factors pro and con to ensure an equitable conclusion.¹⁷

NECA believes ratepayers are fully protected, and best served, by the tariff review and complaint process. These processes should be relied upon as the primary mechanisms for measuring ECs' compliance with interstate access rate of return prescriptions. Interexchange carrier access customers also actively monitor EC

¹⁵ See e.g., New England Telephone and Telegraph Company, 826 F.2d 1101 (D.C. Cir. 1987) which held that the Commission had statutory authority to order a refund in conjunction with AT&T earnings that exceeded the 1978 authorized rate of return prescription. See also Ohio Bell Telephone Company et al. v. FCC, 949 F. 2d 864 (6th Cir. 1991) and AT&T v. FCC, 836 F. 2d 1386 (D.C. Cir. 1988) which invalidated the Commission's automatic refund rule.

¹⁶ See NECA's Comments in CC Docket No. 84-800, Phase I filed on September 3, 1985.

¹⁷ See Las Cruces TV Cable v. F.C.C., 645 F.2d 1041, 1047-1048 (D.C. Cir. 1981) citing Wisconsin Electric Power Co. v. FERC, 602 F.2d 452, 457 (D.C. Cir. 1979) which held that the standard of review of an agency refund order is whether the agency decision is "equitable in the circumstances of this litigation."

earnings and can be relied upon to protest conditions of EC overearnings.¹⁸

IV.B. The Commission Should Prescribe the Authorized Rate of Return on a Total Interstate Access Basis for the NECA Pools.

The Notice invites comment on whether traditional rate of return carriers should be monitored solely on an overall interstate access basis or whether there is need for access category monitoring.¹⁹ NECA recommends that the authorized rate of return for carriers participating in NECA's revenue pools should be prescribed only on a total interstate access basis.²⁰

Approximately 94 percent of the industry is already subject to a total interstate rate of return via price cap regulation. A recent Commission order also proposes to apply the total interstate access parameter to carriers electing an optional incentive plan

¹⁸ Since the introduction of interexchange carrier competition, the Commission has been the recipient of numerous overearnings complaints against exchange carriers. See A.G. Competitive Telecommunications Association, et al. v. Southwestern Bell Telephone Company, Order, File No. E-89-390, (DA 92-1178) rel. Sept. 2, 1992; Execuline of Sacramento, Inc. v. Nevada Bell, Order, File No. 90-255 (DA 92-1179) rel. Sept. 2, 1992; American Network Exchange, Inc. et al. v. United Telephone Company of Kansas, Inc. et al., Order, File No. E-91-156 and 157 (DA 92-1181) rel. Sept. 2, 1992; American Telephone & Telegraph Company v. Northwestern Bell Telephone Company, Order, File No. E-88-21 (FCC 89-343), rel. Jan. 9, 1990; and WCI Telecommunications Corporation v. Southern Bell Telephone and Telegraph Company, Order, File Nos. E-88-45 and 53, 3 FCC Rcd 3146 (1988).

¹⁹ Notice at ¶ 100.

²⁰ See Section 65.700 of the Commission's rules (47 C.F.R. §65.700).

under traditional rate of return regulation.²¹ Pooling exchange carriers, representing the largest portion of the remaining six percent of the industry under traditional rate of return regulation, should likewise be regulated under a rate of return at the total interstate access level. It is inconsistent with the Commission's stated goals to maintain regulatory requirements on this portion of the industry that are more onerous than those applicable to the overwhelming majority of the industry.

Earnings monitoring at a total interstate access level would also help to average the earnings peaks and valleys of the individual pools which result from the variability of actual cost and demand relative to forecasts used in establishing access rates.²² Basing the rate of return on total interstate access will increase the likelihood of NECA pool participants' earning returns at the authorized level and thereby ensure pooling ECs' ability to attract capital for future investments.

Earnings monitoring on a total interstate access level alone will not, however, completely address earnings problems experienced by NECA pool participants. As NECA demonstrates below, ECs remaining under traditional rate of return regulation also require an expansion of the earnings buffer zone to 100 basis points in

²¹ See Small/Midsize Notice at ¶ 12.

²² NECA currently files earnings reports (FCC Form 492), pursuant to Commission order, at a total Common Line and total Traffic Sensitive Pool level of detail rather than at an access service category level as specified in 47 C.F.R. §65.700 (b). See Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, Order, CC Docket No. 84-800 Phase I, 51 Fed. Reg. 11033, April 1, 1986 at note 31.

recognition of earnings fluctuations inherent in the day-to-day activities of this segment of the telecommunications industry.

IV.C. The Commission Should Adopt a 100 Basis Point Buffer Zone for Total Interstate Access Earnings Monitoring.

The Notice invites comment on whether carriers currently subject to traditional rate of return regulation experience earnings fluctuations greater than that experienced by the industry as a whole.²³ NECA submits that its revenue pools do experience earnings fluctuations greater than that experienced by the industry as a whole, and therefore a 100 basis point buffer zone is warranted.

NECA's earnings fluctuations result, principally, from the volatility of pooling ECs' cost and revenues relative to their investment base.²⁴ Small telephone companies are very sensitive to monthly changes in demand and operating costs.²⁵ The departure of a large business may not cause an investment base change, but can result in significantly reduced demand levels and hence revenues.

Specifically, today's Traffic Sensitive Pool experiences a one

²³ Notice at ¶ 101.

²⁴ The Commission's Small/Midsize Notice offers regulatory options to ECs not participating in any NECA pool which, if adopted, could further reduce NECA's investment base, thereby increasing earnings volatility.

²⁵ There are 1,199 study areas participating in NECA's Traffic Sensitive Pool. Over 90 percent of these study areas have less than 10,000 access lines. See NECA's April 2, 1992 Annual Access Charge Tariff Filing, Volume 1 at page 4.

basis point change in earnings for every \$20,800 change in monthly revenues or cost. Similarly, today's voluntary Common Line Pool experiences a one basis point change for every \$21,400 change in monthly revenue or cost. In contrast, prior to April 1, 1989 when all ECs were required to participate in NECA's Common Line Pool, a revenue or cost change of over \$200,000 per month, ten times the current amount, was necessary to cause a one basis point change in Common Line Pool earnings.

This increased sensitivity of the pools to variations in costs and demand also appears in the disparity between the earnings of pooling carriers relative to the industry as a whole. For the 1984 through 1988 period, NECA's Common Line Pool earned an average of 31 basis points below authorized levels.²⁶ The Common Line Pool for this period of time is a reasonable proxy for the "industry as a whole" since the Commission's rules provided for mandatory participation by all local exchange carriers in the United States, Puerto Rico and U.S. Virgin Islands.

In contrast, NECA's Traffic Sensitive Pool for the 1986 through 1990 period averaged 119 basis points below authorized levels.²⁷ Given that today's Traffic Sensitive Pool participation

²⁶ The Common Line Pool for the 1984 through 1988 period earned an average of 12.14 percent which is 31 basis points below the average of the unitary rates of return for this five-year period. The authorized rate of return for the 1984 through 1988 period was 12.75 percent and 12.0 percent for the 1987 through 1988 period.

²⁷ The Traffic Sensitive Pool for the 1986 through 1990 period earned an average of 10.96 percent which is 119 basis points below the levels authorized for that time period. NECA selected this period because the majority of the Bell Operating Companies who chose to participate in the Traffic Sensitive Pool exited after the

is even smaller than this 1986-1990 period, it is reasonable to conclude that pool earnings fluctuations are more difficult to control than in the past few years. These data demonstrate that the NECA pools do experience earnings volatility more extreme than that of the industry as a whole.

NECA recommends that the Commission modify Part 65.700 of its rules (47 C.F.R. §65.700) to reflect an earnings ceiling of 100 basis points over the authorized rate of return, as measured on a total interstate access basis, in recognition of the greater earnings volatility of carriers subject to traditional rate of return regulation.

IV.D. At Least a Two-Year Monitoring Period Should Remain for the NECA Pools.

The Notice seeks comment on whether the Commission should change the current two-year period for compliance with the Commission's rate of return prescriptions. The Notice also states that the current two-year compliance period is theoretically "tied to the two-year reprscription cycle in the current Part 65 rules".²⁸

While the current two-year compliance period is related to the Commission's Part 65 rules, it is not self-evident that the two-year period is only based on the frequency of rate of return reprscriptions. History shows that the Commission has not

1985 access tariff period.

²⁸ Notice at § 102.

necessarily linked rate of return represcriptions with earnings monitoring periods. The rate of return in effect prior to the current represcription was in place for four years (12.0 percent was in place from January 1, 1987 through 1990).²⁹ Further, this very proceeding extends the current 11.25 percent represcription for a period longer than two years.

NECA believes the most compelling reason for maintaining at least a two-year monitoring period can be found in the Commission's 1985 Order acknowledging that more than a one-year period for compliance with a rate of return prescription is need to "reduce the risk of targeting error and the risk that frequent rate changes might be required to remain within the allowable return range."³⁰ This reasoning applies with equal or greater force in today's telecommunications environment and if any change were to be made, the period should be lengthened.

NECA believes that current conditions, characterized by the volatility of the pools which are composed of smaller ECs, warrant continuation of at least a two-year period.³¹ The current two-year earnings period has worked well and at least a two-year period is essential if the NECA pools and other carriers subject to

²⁹ The Commission's interstate rate of return represcription prior to the January 1, 1987 implementation of 12.0 percent was for six years (12.75 percent).

³⁰ Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, CC Docket No. 84-800 Phase I, Order, 50 Fed. Reg. 41350, October 10, 1985 at ¶15.

³¹ The volatility description in Section IV.C *supra* may justify a monitoring period of more than two years.

traditional rate of return regulation are to realize the earnings levels deemed essential by the Commission to attract capital and remain viable providers of telephone service to the public.

V. CONCLUSION


NECA supports the Commission's review of the rate of return prescription procedures and emphasizes that any changes in the procedures should not affect the retention of the unitary rate of return. NECA is willing to assist the Commission in data-gathering associated with the rate of return prescriptions. Since NECA does not currently collect rate of return-type data from its members (both pool and non-pool participants), NECA recommends that Bell Operating Company and other publicly available data be used.

In addition, NECA makes several recommendations for modifications to the represetion procedures. These include: 1) the use of the tariff review and complaint processes for rate of return enforcement with no reenactment of an "automatic refund rule"; 2) the prescription of the authorized rate of return on a total interstate access level for the NECA pools; 3) the adoption of a Commission rule to permit a 100 basis point buffer zone for total interstate access earnings enforcement; and 4) the retention of at least a two-year monitoring period for the NECA pools. NECA requests that its recommendations and a statement concerning the unitary rate of return be incorporated in the Commission's final order in this proceeding.

Respectfully submitted,

NATIONAL EXCHANGE CARRIER
ASSOCIATION, INC.

Anita Hall-Kane
Manager - Regulatory

By 
Joanne Salvatoro Bochi
Its Attorney

September 11, 1992